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IN THE  
**Supreme Court of the United States**

OCTOBER TERM 1947

No. 384

COMMISSIONER OF INTERNAL REVENUE,  
*Petitioner,*

SOUTH TEXAS LUMBER COMPANY,  
*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE FIFTH CIRCUIT.

**RESPONDENT'S MOTION FOR LEAVE TO FILE  
PETITION FOR REHEARING OUT OF TIME  
AND PETITION FOR REHEARING.**

CHARLES C. MacLEAN, JR.,  
*Counsel for Respondent,*  
31 Nassau Street,  
New York, N. Y.

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1947

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No. 384

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

v.

SOUTH TEXAS LUMBER COMPANY,  
Respondent.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE FIFTH CIRCUIT.

**MOTION FOR LEAVE TO FILE PETITION  
FOR REHEARING OUT OF TIME.**

*To the Honorable the Chief Justice of the United States  
and the Associate Justices of the Supreme Court of  
the United States:*

Comes now the respondent in the above-entitled cause and respectfully moves for leave to file at this time the annexed petition for rehearing.

The ground for this motion is that the recent amendment to Rule XXXIII of the Rules of this Court which decreased the time for filing petitions for rehearing as of right from twenty-five days after entry of judgment to fifteen days after entry of judgment or decision was not reflected in the latest supplement to the edition of the Rules of this Court which was consulted for purposes of deter-

mining the time within which to file said petition and that the failure to file a petition within the time specified by the Rules was the result of failure to note such change in the Rules of this Court.

The discretionary jurisdiction of this Court to grant leave to file such petition for rehearing is invoked under said Rule XXXIII which contemplates that the time for filing such a petition may be enlarged. The Court has previously exercised such jurisdiction (*Douglas v. Willcuts*, 293 U. S. 626, 295 U. S. 722, 296 U. S. 1). Under Rule XXXIII the Court has the power vested in both trial and appellate courts, to reconsider its own decisions within the same Term (*Bronson v. Schulten*, 104 U. S. 410, 415; *United States v. Benz*, 282 U. S. 304, 306, 307; *Wayne Gas Co. v. Owens Co.*, 300 U. S. 131, 136; *Hazel-Atlas Co. v. Hartford-Empire Co.*, 322 U. S. 238, 244). This case is not governed by *R. Simpson & Co. v. Commissioner*, 321 U. S. 225 since certiorari was granted herein and the mandate herein has not yet been issued.

The Court granted certiorari herein on petition by the Commissioner on the ground that "the questions thereby raised are of importance in tax administration". It is submitted that, for the same reason, the Court should exercise its discretion to permit the filing of the petition for rehearing in order that the questions may be given full consideration.

Respectfully submitted,

CHARLES C. MACLEAN, JR.,  
Counsel for Respondent,  
31 Nassau Street,  
New York, N. Y.

IN THE  
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COMMISSIONER OF INTERNAL REVENUE,  
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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
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**RESPONDENT'S PETITION FOR REHEARING.**

*To the Honorable the Chief Justice of the United States  
and the Associate Justices of the Supreme Court of the  
United States:*

Comes now the respondent in the above entitled cause  
and presents this its petition for a rehearing, and in sup-  
port thereof respectfully shows:

The question presented to this Court was whether, under  
§115(l) I. R. C., the full amount of the respondent's profits  
on installment sales made prior to the taxable years here  
involved was to be included in the respondent's earnings  
and profits and therefore in its equity invested capital for

excess profits tax purposes. This Court, reversing the decision of the Circuit Court of Appeals for the Fifth Circuit, held that the part of such profits on which no tax had been paid prior to such taxable years was not to be included.

In so deciding, this Court held: first, that the regulation relied on by the Commissioner\* was reasonable and, second, that the regulation was not in conflict with the provisions of §115(l) I. R. C.

The Court's construction and application of §115(l) I. R. C. in its decision herein leads to the result, which this Court could not have contemplated, that the portion of the respondent's profits from installment sales reported for taxation in a year subsequent to the year of sale can *never* be included in the respondent's earnings and profits either for excess profits tax purposes or dividend purposes. The Court was led into this misconstruction of the statute by a false impression as to the nature of the installment method of reporting income created by the Commissioner.

**I. The decision of this Court disregards the statutory provision "under the law applicable to the year in which such sale or disposition was made" contained in Section 115(l) and leads to results plainly contrary to Congressional intent.**

As the Commissioner has conceded, the following provision of §115(l) I. R. C. is applicable to this case:

"Gain or loss so realized [from the sale or other disposition of property] shall increase or decrease the

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\* Reg. 111, §29.115-3 which provides: "• • • a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis • • •"

earnings and profits to, *but not beyond*, the extent to which such a realized gain or loss was recognized in computing net income *under the law applicable to the year in which such sale or disposition was made.*" (Italics added.)

The Court held that there is no conflict between the regulation in question and this statutory provision (requiring the inclusion in earnings and profits of all gain satisfying the statutory tests) because the portion of the profit from an installment sale which is properly reportable for taxation in a year subsequent to the year of sale is *not*

"recognized in computing net income under the law applicable to the year in which such sale or disposition was made"

within the meaning of the statute. In order to reach this conclusion, the Court

(a) construed the "recognition" requirement of §115(l) above quoted as referring to §44 and §111(d) (relating to installment sales) of the revenue acts applicable to the years of sale, and

(b) construed §44 and §111(d) (as they appeared in the Revenue Act of 1936, the Revenue Act of 1938 and the Internal Revenue Code for 1941) as providing for the *non-recognition* of the part of the gain from an installment sale which is properly subjected to tax in a year subsequent to the year in which the sale was made.

It is respectfully submitted that the construction so placed by this Court upon the statutes involved disregards the full effect of the phrase "under the law applicable to the year in which such sale or disposition was made" appearing in §115(l) and leads to results which Congress

could never have intended. The nature of those results may be aptly illustrated by the facts of the present case.

Most of the installment sales here involved were made in 1937 (R. 27). The law applicable to the year of such sales was the Revenue Act of 1936. This Court in its decision held that part of the profits from such sales which was subject to tax in years subsequent to 1937 was not "recognized in computing net income under the law applicable to the year in which such sale or disposition was made", i.e., under the Revenue Act of 1936. In so doing, as appears from the opinion, the Court naturally assumed that all of the gain would *eventually* meet the statutory test and enter earnings and profits. However, that cannot be the result under the statute as construed by the Court.

Under the provisions of §115(1), profits from sales can enter earnings and profits at any time *only* if they are "recognized in computing net income *under the law applicable to the year in which such sale or disposition was made.*" By reason of the provisions of §63 of the Revenue Act of 1938, *none of the income tax provisions of the Revenue Act of 1936 applies to any taxable year of the respondent after 1937.\** From this fact and the decision of this Court it would follow that the part of the profits from installment sales made in 1937 which was in later years included in the respondent's taxable income under the *Revenue Act of 1938*, and revenue laws applicable to *other years subsequent to the year of sale*, was not recognized under the *Revenue Act of 1936*, which was "the law applicable to the year in

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\* Section 63 of the Revenue Act of 1938 provides:

"Sec. 63. *Taxes in Lieu of Taxes Under 1936 Act.*—The taxes imposed by this title and Title IA shall be in lieu of the taxes imposed by Titles I and IA of the Revenue Act of 1936, as amended."

which such sale or disposition was made." The necessary consequence of this Court's holding is that such profits could *never* be included in the respondent's earnings and profits, even after such profits had been subjected to tax.

Recognition of such profits under the law applicable to a year *subsequent* to the year of sale would not satisfy the test of §115(1), because such subsequent year is not "the year in which such sale or disposition was made."

The consequence of this Court's holding that such profits were not recognized under the law of the year of sale, as required by §115(1) for inclusion in earnings and profits, would be (a) that the respondent would *never* be able to include such profits, even when tax-paid, in its accumulated earnings and profits for purposes of its invested capital credit, and (b) that the respondent could *at any time* distribute such profits to its stockholders free of dividend tax. The same considerations apply to profits from installment sales made by the respondent in years after 1937.

These results certainly could not have been intended by Congress. Yet they are inevitable under the construction which this Court has read into the applicable statutory provisions—a construction which is neither required nor suggested by their language.

During the course of this proceeding the Commissioner has, from time to time, urged various constructions of the phrase "recognized in computing net income" as it is used in §115(1). But the above-mentioned results would follow from any holding that any part of the profit from an installment sale was not "recognized in computing net income" under the law applicable to the year of sale, regardless of the meaning attached to the phrase "recognized in computing net income." If, as this Court holds, the part of the profit from an installment sale which is properly taxed

in a year subsequent to the year of sale is not "recognized in computing net income" (whatever meaning is attached to that phrase) "under the law applicable to the year in which such sale or disposition was made," such part of the profit will never meet the statutory test of §115(1) for inclusion in earnings and profits and therefore can never enter earnings and profits.

It is submitted, therefore, that in construing the statutes here involved this Court overlooked the significance of the phrase "under the law applicable to the year in which such sale or disposition was made," with the result that the decision of the Court deprives the statutes of sensible meaning and gives them a meaning which could never have been intended by Congress. The statutes can be given a sensible meaning only by construing §115(1) as referring to the recognition provisions of §112 in effect in the year of sale, under which, in each case, the full amount of the gain from an installment sale was recognized.

## **II. The decision of this Court was based upon an erroneous conception of the nature of the installment method of reporting income.**

Both in holding the regulation relied on by the Commissioner to be reasonable and in construing §115(1), the Court was misled by the Commissioner's claim that the installment method of reporting income was a separate and independent system of accounting. By this claim, which is irrelevant otherwise, the Commissioner created the false impression that the installment method has the symmetry to be expected of a system of accounting. Actually, its demonstrable lack of symmetry constitutes a strong reason in support of the view that the installment method does not constitute a separate and independent method of accounting.

I. In holding the regulation relied on by the Commissioner to be reasonable, this Court mistakenly relied on the general principle that both income and deductions must be computed under the same method of accounting. *That principle does not apply where income is reported on the installment method because deductions are never taken on the installment basis.* This is expressly provided in the regulations relating to installment sales (Reg. 111, §29.44-1) as follows:

“Deductible items are *not* to be allocated to the years in which the profits from the sales of a particular year are to be returned as income, *but must be deducted for the taxable year in which the items are ‘paid or incurred’ and ‘paid or accrued,’* as provided by sections 43 and 48.” (Italics added.)

The same provision (with slight differences in wording) has been in the regulations ever since Reg. 69, Art. 42 was adopted under the Revenue Act of 1926, the first Revenue Act to permit the installment method.

One of the reasons why the installment method was held in *B. B. Todd, Inc.*, 1 B. T. A. 762, 764 (1925) before the adoption of §44 to be a method of accounting which did not clearly reflect income was that under the statute all deductions (including those relating to the installment sales) were required to be reported on either the accrual basis or the cash basis, according to the taxpayer's method of reporting other transactions. Congress subsequently, by specific legislation, authorized the use of the installment method of reporting *income*, notwithstanding the fact that *deductions* were still required to be reported on either the cash or the accrual method.

Under those circumstances it would seem proper to regard §44 as merely deferring taxation of installment gains

until cash to pay the tax is in hand. If, however, §44 is taken instead to provide a separate and independent "system of accounting," such a system is, as this Court said, a "hybrid method" of accounting, the hybrid nature of which is due to "the Commissioner's regulations and to long-standing tax practices recognized by statutes and judicial opinions." In relying on the general principle that income and deductions must be reported on the same basis, the Court was clearly not aware of the hybrid nature of the installment method itself.

It is submitted, therefore, that this Court's holding that the regulation relied on was reasonable was based on a misapprehension as to the nature of the installment method of reporting income.

2. This misapprehension of the essentially hybrid nature of the installment method of reporting income was also behind the Court's holding that the regulation relied on by the Commissioner was not in conflict with §115(1).

The Committee Reports on §115(1) (quoted in the Court's opinion) refer only to §112 I. R. C. in explaining the meaning of the term "recognized" as used in §115(1). In spite of that fact this Court declined to construe §115(1) as referring to §112 I. R. C. and the corresponding recognition sections of prior revenue acts. This Court was led to reject the obvious construction of the term "recognized" in §115(1) as referring to §112 on the theory\* that Con-

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\* The Court said:

"In the first place, neither §115(1) nor any other purports to alter the Commission's power to promulgate reasonable regulations which require taxpayers who adopt the installment basis of accounting to use an accounting method that reflects true income. The hybrid method here urged would not accomplish that result."

gress could not have intended to authorize a "hybrid method" of accounting by permitting (under §115(1) or any other section) deductions to be taken on the accrual basis where income is reported on the installment basis. Such doubts as to the Congressional intent vanish, however, when it is understood that Congress, after the decision in the *Todd* case, *supra*, specifically authorized the installment method of reporting income notwithstanding the fact that, considered as a system of accounting, such method is clearly a "hybrid method" in which income is reported on one basis and deductions are reported on another.

WHEREFORE, respondent respectfully petitions for a rehearing and prays that the decision of the United States Circuit Court of Appeals for the Fifth Circuit be affirmed.

Respectfully submitted,

CHARLES C. MACLEAN, JR.  
Counsel for Respondent,  
31 Nassau Street,  
New York, N. Y.

### Certificate of Counsel.

I, CHARLES C. MACLEAN, JR., counsel for the above-named respondent, do hereby certify that the foregoing petition for a rehearing is presented in good faith and not for delay.

CHARLES C. MACLEAN, JR.  
Counsel for Respondent.

# SUPREME COURT OF THE UNITED STATES

No. 384.—OCTOBER TERM, 1947.

Commissioner of Internal Revenue,  
Petitioner,

v.

South Texas Lumber Company.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[March 29, 1948.]

MR. JUSTICE BLACK delivered the opinion of the Court.

This case raises a question as to respondent's liability for the taxable year 1943 under the Excess Profits Tax of 1940 as amended. 54 Stat. 975, 26 U. S. C. § 710, *et seq.* The law was passed to tax abnormally high profits due to large governmental expenditures about to be made from appropriations for national defense.<sup>1</sup> The excess profits tax was a graduated surtax upon a portion of corporate income, and was imposed in addition to the regular income tax. It applied to all corporate profits and gains over and above what Congress deemed to be a fair and normal return for the corporate business taxed.

Under the controlling 1943 law the amount of income subject to this excess profits tax is computed by subtracting from the net income subject to regular income tax the amount of earnings Congress deemed to be a taxpayer's normal and fair return.<sup>2</sup> This deductible amount, called the excess profits credit, was to be computed in one of two ways, whichever resulted in the lesser tax. § 712. The first, not used here, permits a deduction of an amount equal to the company's average net income for the taxable years 1936 to 1939 inclusive. § 713. The

<sup>1</sup> H. R. No. 2894, 76th Cong., 3d Sess., 1-2.

<sup>2</sup> Other adjustments not here material are provided, but the chief deduction or "adjustment" is the one noted above.

second, used here, permits a deduction of an amount equal to 8 per centum of the taxpayer's invested capital for the taxable year.<sup>3</sup> § 714. An includable element of the "invested capital" is the "accumulated earnings and profits as of the beginning of such taxable year." It thus appears that by this method Congress intended, with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's working capital, including its accumulated profits. The controversy here is over the taxpayer's claim that in computing its 1943 tax the statute allows it to include in this 8% deduction its "accumulated profits" from certain installment sales, which profits the taxpayer, in accordance with an option conferred upon him, had elected not to report as a part of its taxable income in prior years.

Beginning in 1937 and extending over a four-year period, respondent sold parcels of real estate, gave deeds, and took installment notes, which were secured by mortgages and vendors liens. It kept its books generally on a calendar year accrual basis of accounting, a basis under which all obligations of a company applicable to a year are listed as expenditures, whether paid that year or not, and all obligations to it incurred by others applicable to the year are set up as income on the same basis. Under 26 U. S. C. § 41 an income taxpayer may report income and expenditures either on an accrual basis, or on a cash basis—under which latter method annual net income is measured by the difference between actual cash received and paid out within the taxable year. In any event, the basis used must, in the language of § 41, "clearly reflect the income."

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<sup>3</sup> The straight 8% figure of 1940 was modified in several respects not here material in 1941 and subsequent years. 55 Stat. 699; 56 Stat. 911; 58 Stat. 55.

Respondent did not report the value of its land installment notes as income on the accrual basis as it could have done under § 41. Instead, from 1937 up to and including 1943, it has consistently reported its annual income from the installment sales on a third, or "installment" basis, expressly authorized for certain types of installment sales by 26 U. S. C. § 44. That section permits a taxpayer to return as taxable income for a given year only "that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price." Thus respondent's installment income has actually been reported for taxes all along substantially on a modified cash receipts basis, and the taxpayer's net income, which is subjected both to the normal income tax and to the excess profits tax, has not in any of these years reflected the unpaid balances on the installment notes, or any part of them. On the contrary, these balances were listed on respondent's tax returns during these years as "Unrealized Profit Installment Sales."

On its 1943 excess profits tax return respondent nevertheless reported as "accumulated earnings and profits" the amount of "Unrealized Profit Installment Sales" shown on its books at the end of 1942,<sup>4</sup> and included this amount in "invested capital." It thus sought to deduct 8% of its theretofore designated "unrealized profit" in computing its excess profits tax. The Commissioner redetermined the tax for 1943 after eliminating this item from "invested capital." The Tax Court sustained the Commissioner's redetermination, 7 T. C. 669, relying on its opinion in *Kimbrell's Home Furnishings Inc.*, 7 T. C.

<sup>4</sup> In its 1943 return respondent also reported the amount of such unrealized profits shown on its books as of the end of the two preceding years for purposes of calculating the excess profits credit carryover authorized by § 710 (c).

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339.<sup>5</sup> The Circuit Court of Appeals, with one justice dissenting, reversed on the authority of its decision in *Commissioner v. Shenandoah Co.*, 138 F. 2d 792. The Government's petition for certiorari alleged that the result reached by the Circuit Court of Appeals was counter to the Commissioner's regulations and to long-standing tax practices recognized by statutes and judicial opinions, under which practices a taxpayer normally cannot report taxable income on one accounting basis and adjustments of that income on another. The questions thereby raised are of importance in tax administration and we granted certiorari to consider them.

A Treasury regulation, set out in part below,<sup>6</sup> applicable to both the normal income tax and the excess profits tax,<sup>7</sup> specifically provides that "a corporation computing income on the installment basis as provided in section 44

<sup>5</sup> The *Kimbrell* case was subsequently reversed but not on the contention here urged. 159 F. 2d 608.

<sup>6</sup> Section 29.115-3 of Regulations 111: "*Earnings or Profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance, a corporation keeping its books and filing its income tax return under sections 41, 42, and 43 on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; . . ."

<sup>7</sup> The meaning of all terms used in the subchapter dealing with the income tax was expressly made applicable to terms used in the excess profits subchapter. § 728. Treasury Regulations 112 provided: ". . . In general, the concept of 'accumulated earnings and profits' for the purpose of the excess profits tax is the same as for the purpose of the income tax." § 35.718-2. See also H. R. No. 2894, 76th Cong., 3d Sess., 41.

shall, with respect to the installment transactions, compute earnings and profits on such basis." \* Since respondent computed its taxable income from installment sales on the installment or modified cash receipts basis, but computed its earnings and profits from these same sales on another basis, the accrual, it contends that the regulation is invalid because inconsistent with the governing code provisions. Validity of the regulation is therefore the crucial question.

This Court has many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons. See, e. g., *Fawcus Machine Co. v. United States*, 282 U. S. 375, 378.

This regulation is in harmony with the long-established congressional policy that a taxpayer generally cannot compute income taxes by reporting annual income on a cash basis and deductions on an accrual basis. Such a practice has been uniformly held inadmissible because it results in a distorted picture which makes a tax return fail truly to reflect net income. This has been the construction given income, estate, and previous excess profits tax laws by administrative officials, the Board of Tax Appeals, and the courts.

\* This part of the regulation was added as an amendment to Reg. 103, § 19.115-3, now § 29.115-3 of Reg. 111, after adoption of the 1940 Excess Profits Tax Law. T. D. 5059, July 8, 1941.

\* G. C. M. 2951, VII-1 Cum. Bull. 160 (1928); I. T. 3253, 1939-1 Cum. Bull. 178; *Consolidated Asphalt Co.*, 1 B. T. A. 79, 82; *Henry Reubel Executor*, 1 B. T. A. 676, 678-680; *B. B. Todd, Inc.*, 1 B. T. A. 762, 766; *Bank of Hartsville*, 1 B. T. A. 920, 921; *Atlantic Coast Line R. Co.*, 2 B. T. A. 892, 894-895; *United States v. Anderson*, 209 U. S. 422, 440; *Jacob Bros. v. Comm'r*, 50 F. 2d 394, 396; *Jenkins v. Bitgood*, 22 F. Supp. 16, 17-18, aff'd., 101 F. 2d 17.

The regulation's reasonableness and consistency with the statutes which impose the excess profits tax on incomes is also supported by prior legislative and administrative history. The present "invested capital" deduction is patterned after a similar provision in § 326 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1088, 1092. That section imposed a "War Profits and Excess Profits Tax." Invested capital there included "paid in or earned surplus and undivided profits." Under that law the administration, the Board of Tax Appeals, and the courts have uniformly held that a taxpayer, having elected to adopt the installment basis of accounting, could not thereafter distort his true excess profits tax income by including uncollected installment obligations in his "invested capital" deduction base.<sup>10</sup> A taxpayer, having chosen to report his taxable income from installment sales on the installment cash receipts plan, thereby spreading its gross earnings and profits from such sales over a number of years and avoiding high tax rates, was not permitted to obtain a further reduction by shifting to an accrual plan and treating uncollected balances on these installment sales as though they had actually been received in the year of the sale.

The history of the congressional adoption of the optional installment basis also supports the power of the Commissioner to adopt the regulation here involved. Prior to 1926 the right of a taxpayer to report on the

<sup>10</sup> *Schmoller & Mueller Piano Co. v. United States*, 67 C. Cls. 428; *John M. Brant Co. v. United States*, 40 F. 2d 126; *Standard Computing Scale Co. v. United States*, 52 F. 2d 1618; *Jacob Bros. v. Comm'r*, 50 F. 2d 394; *Tull & Gibbs v. United States*, 48 F. 2d 148; *Blum's Inc. v. Comm'r*, 7 B. T. A. 737, 771; *New England Furniture & Carpet Co. v. Comm'r*, 9 B. T. A. 334; *Green Furniture Co. v. Comm'r*, 14 B. T. A. 508; *S. Davidson & Bros. v. Comm'r*, 21 B. T. A. 638, 644; *Federal St. & Pleasant Valley Passenger R. Co. v. Comm'r*, 24 B. T. A. 262, 266.

installment plan rested only on Treasury regulations.<sup>11</sup> In 1925, the Board of Tax Appeals held these regulations were without statutory support.<sup>12</sup> Congress promptly, in § 212 (d) of the 1926 Revenue Act, adopted the present statutory authority for an elective installment basis for reporting income, the Senate committee report on the measure designating it as a "third basis, the installment basis."<sup>13</sup> This new statutory provision was strikingly similar to the Treasury regulations previously held unauthorized by the Board of Tax Appeals. That the Commissioner was particularly intended by Congress to have broad rule-making power under the regulation was manifested by the first words in the new installment basis section which only permitted taxpayers to take advantage of it "Under regulations prescribed by the Commissioner with the approval of the Secretary . . . ." The clause is still contained in § 44 of the code. This gives added reasons why interpretations of the Act and regulations under it should not be overruled by the courts unless clearly contrary to the will of Congress. See *Burnet v. S. & L. Bldg. Corp.*, 288 U. S. 406, 415.

The installment basis of reporting was enacted, as shown by its history, to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had received in cash only a small portion of the sales price. Another reason was the difficult and time-consuming effort of appraising the uncertain market

<sup>11</sup> Article 117 of Regulations 33 (Revised) promulgated Jan. 2, 1918, and Article 42 of Regulations 45, promulgated April 17, 1919.

<sup>12</sup> *B. B. Todd Inc.*, 1 B. T. A. 762; *H. B. Graves Co.*, 1 B. T. A. 859; *Hoover Bond Co.*, 1 B. T. A. 929; *Six Hundred and Fifty West End Avenue Co.*, 2 B. T. A. 958.

<sup>13</sup> S. Rep. No. 52, 69th Cong., 1st Sess., 19, the Senate Finance Committee's report on Revenue Act of 1926, 44 Stat. 9, 23.

value of installment obligations." There is no indication in any of the congressional history, however, that by passage of this law Congress contemplated that those taxpayers who elected to adopt this accounting method for their own advantage could by this means obtain a further tax advantage denied all other taxpayers, whereby they could, as to the same taxable transaction, report in part on a cash receipts basis and in part on an accrual basis.

We find nothing unreasonable in the regulations here. See *Commissioner v. Wheeler*, 324 U. S. 542.

It is argued that notwithstanding what has been said, Congress by enacting § 501 of the 1940 Second Revenue Act, 54 Stat. 974, 1004, 26 U. S. C. § 115 (1), had provided a definition of "earnings and profits" which includes these unpaid installment obligations and that the regulation here conflicts with § 115 (1),<sup>15</sup> which is applicable alike to both the income and the excess profits taxes. There are at least two reasons why we cannot accept this argument. In the first place, neither § 115 (1) nor any other purports to alter the Commission's power to promulgate reasonable regulations which require taxpayers who adopt the installment basis of accounting to use an accounting method that reflects true income. The hybrid method here urged would not accomplish that result.

<sup>14</sup> S. Rep. No. 52, 69th Cong., 1st Sess. 19; *Willcuts v. Gradwohl*, 58 F. 2d 587, 589-590.

<sup>15</sup> Section 115 (1) provides: "The gain or loss realized from the sale or other disposition of property by a corporation—

"(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

"Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made."

In the second place, we cannot agree with the respondent's interpretation of § 115 (1). He argues that "earnings and profits" derived from a sale of property are defined in § 115 (1) considered in the light of §§ 111, 112, and 113; that these sections together define such earnings and profits as all gain "realized" in the year of sale and "recognized" under the law applicable to the year of sale; that all the anticipated profits from these installment sales were "realized" when the sales were made because the installment obligations of the purchasers were received by respondent in the year of sale and they must be assumed to have been worth their face value; that they were "recognized" as taxable by § 111 (c), the law applicable to the year of sale; and that consequently, the Commissioner was compelled to accept these lawfully "realized" and "recognized" accumulated profits as "invested capital" for excess profits tax purposes, even though not previously reported as taxable income for either income tax or excess profits tax purposes. Finally respondent contends that § 44 merely conferred upon it a privilege to defer payment of income tax on its tax-"recognized" profits realized from installment sales until the unpaid installment obligations were collected.

The congressional reports on § 115 (1) do not provide support for the idea that gains not included in taxable income under the taxpayer's method of accounting may nevertheless be considered "realized" and "recognized" for computing tax adjustments or deductions so long as they might have entered into such computations under a different method of accounting.<sup>10</sup> Furthermore, neither

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<sup>10</sup> The Conference Committee report on the Second Revenue Act of 1940, 54 Stat. 974, said with reference to § 115 (1): "The provisions in the House and Senate bills, that gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent recognized in computing net income under the law applicable

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§§ 111, 112, nor 113, require a "recognition" of the full face value of installment paper. It is true that § 111 (b) does provide that gain or loss "realized" from the sale of property shall be measured by the "sum of any money received plus the fair market value of the property (other than money) received" and § 111 (c) provides that the extent of gain or loss shall be "recognized" as determined "under the provisions of section 112." But § 111 (d) provides that nothing in § 111 "shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received." This means that where a taxpayer has validly reported its income from installment sales on the installment basis provided by § 44, that section, not §§ 111, 112, and 113 prescribes the extent to which receipts from such sales are "recognized" as taxable and the year in which such receipts are "recognized" in computing taxable income. Section 44 provides for the return as income "in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price." Unlike § 111, § 44 does not recognize as subject to income tax liability the "market value" of deferred installment obligations. They may never be recognized by a taxpayer on the installment basis for tax purposes under § 44 or any other section, for they may never be paid, or may be paid only in part. The anticipated profits from these deferred obligations are

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to the year in which such sale or disposition was made, are retained. As used in this subsection the term 'recognized' relates to a realized gain or loss which is recognized pursuant to the provisions of law, for example, see section 112 of the Internal Revenue Code. It does not relate to losses disallowed or not taken into account." Conf. Rep. No. 3002, 76th Cong., 3d Sess., 60.

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recognized and taxable under § 44 only if the obligations are paid and when they are paid, unless they are sold or transferred before payment. Thus whatever meaning is given to the words "realized" and "recognized" the regulation here considered is not in conflict with §§ 115 (1), 111, 112, and 113.

The regulation is valid. The respondent can include in its equity invested capital only that portion of its profits from installment payments which it has actually received and on which it has already paid income taxes in the years of receipt.

*Reversed.*

MR. JUSTICE DOUGLAS and MR. JUSTICE BURTON dissent.